STATE OF MICROFINANCE IN INDIA: A CRITICIAL OVERVIEW

ABSTRACT

The Microfinance sector in India has been a crucial gateway to mainstream financial services and subsequent social upliftment for millions of people, especially women, and proved its mettle, though not without several hiccups, as a reliable, sustainable and operable financial mechanism with paradigm-changing and far-reaching impacts.

Pioneered by Muhammad Yunus in Bangladesh as a low-cost means of availing credit for the marginalized and the unbanked, it soon found resonance across the developing world, even becoming a favoured means of social welfare by governments across the world. However, while the initial response to the sector was overwhelming and even promoted by Development Financial Institutions (DFIs) in India, crises like the 2010 Andhra Pradesh crisis exposed the sector's vulnerabilities and necessitated reforms, which have been going on till recently.

With the advent of fintech, it becomes necessary to understand the role technology can play in the expansion of the microfinance sector and also tackle with the problems plaguing the sector for long.

Keywords: *microfinance, financial inclusion, social welfare, equity, women empowerment, behavioural sciences, over indebtedness, regulation*

INTRODUCTION

Access to financial services, especially for the marginalized and socio-economically deprived, is considered to be the key to equitable, inclusive and sustainable development. Often flagged by financial institutions and intermediaries as high risk and high-cost potential clients owing to their inaccessibility, small amounts of debt transactions , rigid institutional policies and prevailing misconceptions about them , all of which sum up to transactions with the unbanked being viewed as a zero-sum game ; such attitudes however , end up worsening off the latter by denying opportunities for gainful employment and needed investments in education , nutrition and healthcare , further ingraining the cycle of deprivation and poverty .

Microfinance, pioneered and popularized by the Bangladeshi Nobel laureate Muhammad Yunus, seeks to bridge the 'financial' divide and bring more people into the banking mainstream. It refers to banking service provided to unemployed or low-income individuals or groups who otherwise would have no other access to financial services, especially in Emerging Markets and Developing Economies (EMDEs), with credit ranging from very negligible amounts and paid back with interest in tune with ethical banking considerations. This report aims at understanding the state of the microfinance sector in India, especially in the aftermath of the COVID-19 pandemic, and the opportunities and challenges the sector presents.

MICROFINANCE...WHAT IS IT EXACTLY?

"*Microfinance Institutions (MFIs) seek to provide small-scale credit and other financial services to low-income households and very small informal businesses by providing a mechanism for the poor and the unbanked to smooth the effects of income shocks on consumption, find safe and affordable repositories for their savings, take advantage of profitable investment opportunities, and insure risk.*" (*Microfinance: A View from the Fund, International Monetary Fund, 2005*).

Similarly, the Reserve Bank of India (RBI) puts forth microfinance as *"...an economic development tool whose objective is to assist the poor to work their way out of poverty. It covers a range of services which include, in addition to the provision of credit, many other services such as savings, insurance, money transfers, counseling, etc.*" (*Report of the Sub-Committee of the Central Board of Directors of the Reserve Bank of India to Study Issues and Concerns in the MFI Sector, 2011).*

Microfinance or microcredit services are provided to the economically deprived and the unemployed, who are often analogous to the socio-politico-economically deprived sections of the society, who find it nearly impossible to deal gainfully with mainstream financial institutions often due to lack of an adequate income and instead fall prey to loan sharks and other informal financial intermediaries. Microfinancing organizations support a large number of activities that range from providing the basics—like bank checking and savings accounts—to startup capital for small business entrepreneurs and educational programs that teach the principles of investing.

WHAT MARKS MICROFINANCE APART FROM CONVENTIONAL FINANCING?

"*Microfinance has already shown that enabling the poor to empower themselves economically can be a good business*".

- Pierre Omidyar

What marks microfinance apart from conventional financing is that while both charge interest to debtors, the latter is primarily concerned with the borrower having enough collateral to cover the loan while many microfinance organizations focus on helping entrepreneurs succeed and making gainful contributions to the economy. The benefits of microfinance often spill over create jobs, trade, and overall economic improvement within a community; the World Bank estimates that around 500 million people have benefited directly or indirectly from microfinance activities.

Another significant difference is that while formal banking institutions function on a profit motive, providing loans to individuals on the basis of their creditworthiness or government policy, especially in the case of frontier markets, while microfinance institutions aim at providing debt particularly to women and other deprived sections on concessionary terms and relying primarily on community networks for their operations.

THE EVOLUTION OF MICROFINANCE IN INDIA

"*Microfinance recognizes that poor people are remarkable reservoirs of energy and knowledge, posing an untapped opportunity to create markets, bring people in from the margins and give them the tools with which to help themselves*".

- Kofi Annan

In India, one of the most significant elements are the Self-Help Groups (SHGs), mainly driven and operated by women in rural areas with a motive of achieving economic self -reliance and gainful employment; the widespread coverage and accessibility which membership to SHGs provides is being harnessed under the goals of technology-enabled financial inclusion and empowerment, themselves part of the idea of the JAM (Jan Dhan -Aadhar – Mobile) Trinity under the Digital India Mission.

In India, following the nationalization of banks in 1969 and 1980, 'banking to the unbanked' was considered necessary as a part of policies targeting poverty reduction, women empowerment, assistance to vulnerable groups, improvement in standards of living and more recently, sustainable development. In India, microcredit is delivered through a wide range of intermediaries, which includes Scheduled Commercial Banks (SCBs) including Small Finance Banks (SFBs) and Regional Rural Banks (RRBs) which operate either through Banking Correspondents (BCs) or deal directly with clients, Co-operative Banks, Non-Banking Financial Companies (NBFCs) registered as Microfinance Institutions (MFIs) or otherwise, and Self – Help Groups (SHGs).

The portfolio of the microfinance sector in India is catered to by a wide range of intermediaries, elucidated by Table 1.1:

Sr. No.	Parameters	Details		
1.	**Loan portfolio**	**Number of lenders**	**Loan amount outstanding (₹ in crore)**	**Percentage share**
	Industry level	197	2,27,942	100%
a)	Banks	15	93,432	40.99%
b)	NBFC-MFIs	86	70,196	30.80%
c)	SFBs	8	42,689	18.73%
d)	NBFCs	55	19,848	8.71%
e)	Non-profit MFIs	33	1,777	0.78%
2.	**Number of active loans**	**Number of lenders**	**Number of loans (in lakh)**	**Percentage share**
	Industry level	197	1,030	100%
a)	Banks	15	367.42	35.69%
b)	NBFC-MFIs	86	362.37	35.19%
c)	SFBs	8	203.40	19.76%
d)	NBFCs	55	85.84	8.34%
e)	Non-profit MFIs	33	10.56	1.03%
3.	**Portfolio performance (Delinquency in terms of days past due)**	**30+ days**	**60+ days**	**90+ days**
	Industry level	4.48%	1.02%	0.63%
a)	Banks	6.04%	0.74%	0.60%
b)	NBFC-MFIs	4.21%	1.63%	1.25%
c)	SFBs	2.79%	0.61%	0.26%
d)	NBFCs	2.04%	1.05%	0.35%
e)	Non-profit MFIs	1.38%	0.76%	0.55%
4.	**Geographical spread**			
a)	Overall coverage	628 districts across 37 states and union territories		
b)	Top five states in terms of share in loan portfolio as a share of total loan portfolio	Tamil Nadu (16.19%), Bihar (11.10%), West Bengal (10.53%), Karnataka (8.88%), and Maharashtra (8.06%)		

Note: Information as on September 30, 2020 sourced from Q-MF (a quarterly report on microfinance sector published by Sa-Dhan, a self-regulatory organization for MFIs)

Table 1.1: Portfolios of the Microfinance Sector in India (2020)

(*Source: Consultative Document on the Regulation of Microfinance (2021), Reserve Bank of India*)

Figure 1-1: Sources of Microfinance in India

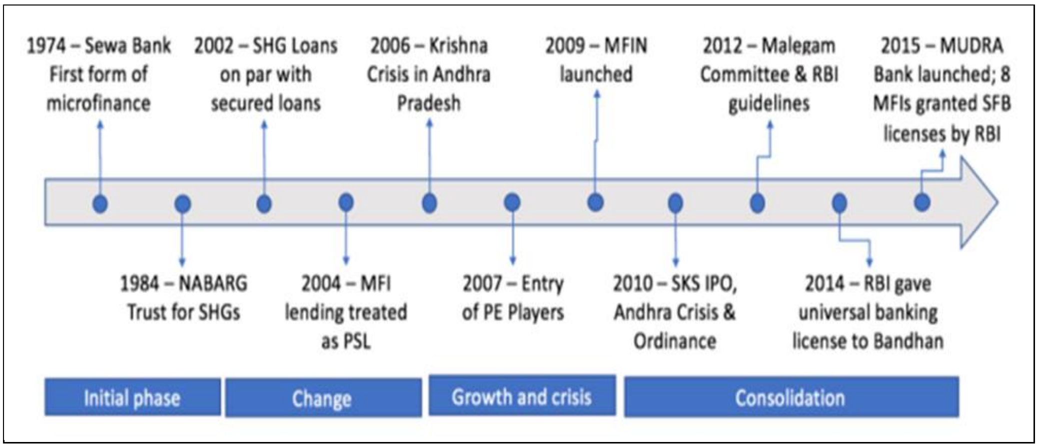


Figure 1-2: Evolution of Microfinance in India

THE RUMBLINGS ...AND THE IMBROGLIO ...

The development of the MFIs received a boost in the 1990s following its recognition as a new paradigm of immense growth potential by the RBI. While demands for regulating the microfinance sector were initially met with diffidence to the sector which persisted right up to the 2010s, the Andhra Pradesh Microfinance Crisis of 2010 (see *Table 1-2*) triggered a flurry of regulatory measures, culminating in recommendations of the Y.H Malegam Committee in 2011.

Table 1-2: The 2010 Andhra Pradesh (AP) Microfinance Crisis

… "market penetration has continued its rapid growth, with Indian MFIs adding six million customers in 2009. This is of course good news. The less good news is that the state that was already the most heavily penetrated in 2008 – Andhra Pradesh – was also the largest contributor to that growth, adding nearly 1.3 million customers." (Rozas and Sinha, 2010).

Andhra Pradesh in particular had the unique distinction of not only having the greatest penetration and growth of MFIs, but also aggressive growth of the SHGs bolstered by the World Bank-aided Indira Kranti Patham (IKP) programme which pumped a large amount of money into the rural sector, and all the livelihood projects were being managed through promotion of SHGs and their federal structures.

However , despite the immense interest shown by the state machinery , it was overlooked that excessive penetration of MFIs and over-exposure of clients and institutions alike to often the same areas of operation , coupled with concerns over excessive commercialization with the entry of private equity investments and requirements of rapid growth for building an IPO track record , multiple lending and reorganization of MFIs into for-profit firms with the gradual conversion of charity funds into equity funds , as witnessed in the 2010 IPO of SKS Microfinance .

With the vernacular press carrying news of alleged suicides of MFI clients due to over-indebtedness and coercion to ensure repayments, which seemed to be bolstered by the fact that nearly 100% repayments had been reported for years by many MFIs. While this worked positively in building the organizations as responsible lenders who brought discipline to the chaotic market that was marred with delinquency and write offs, it was now termed inhuman and coercive, even resulting in significant backlash against the entire sector in popular media and the state's legislative assembly , culminating in the Andhra Pradesh Micro Finance Institutions Ordinance , 2010 which included provisions like those mandating registration of MFIs , penalization of MFI loan sharks ,strengthening client rights and setting up fast-track courts for dispute resolution .

MICROFINANCE …WHAT'S BEING DONE TO PROMOTE IT?

Recognizing the potential of the microfinance sector as a means of alleviating rural poverty and ensuring greater, gainful employment for the rural masses, especially women, early on, financial institutions like the Reserve Bank of India (RBI), the National Bank for Agriculture and Rural Development (NABARD) and the Small Industries Development Bank (SIDBI) have been working on harnessing the sector through various initiatives.

i. Self-Help Group – Bank Linkage Programme (SHG- BLP):

The Self-Help Group – Bank Linkage Programme (SHG-BLP) was launched in 1992 by the National Bank for Agriculture and Rural Development (NABARD), after a consultative study by the Mysore Resettlement and Development Agency (MYRDA) in 1987.

The Programme was launched with certain objectives , including : (i) to evolve supplementary credit strategies for meeting the credit needs of the poor by combining the flexibility, sensitivity and responsiveness of the informal credit system with the strength of technical and administrative capabilities and financial resources of the formal credit institutions; (ii) to build mutual trust and confidence between the bankers and the rural poor; and (iii) to encourage banking activity, both on the thrift as well as on credit sides, in a segment of the population that the formal financial institutions usually find difficult to cover.

While the SHGs were expected to facilitate collective decision making by the poor and provide 'doorstep banking' and the banks as wholesalers of credit, were to provide the resources, the NGOs were to act as agencies to organize the poor, build their capacities and facilitate the process of empowering them. This was expected to be a win-win situation for both the banks and the SHGs as the former would gain by a way of reduction in their transaction costs due to reduction in work relating to appraisal, supervision and monitoring of loans, while the latter would benefit by getting access to a larger quantum of resources, as compared to their meager corpus generated through thrift. While the pilot project envisaged linking of only 500 SHGs to banks, the figure reached 620 by March 1994, marking it a success.

It has proved its efficacy as a mainstream programme for banking with the poor, who mainly comprise the marginal farmers, landless labourers, artisans and craftsmen and others engaged in small businesses such as hawking and vending in the rural areas. The main advantages of the programme are timely repayment of loans to banks, reduction in transaction costs both to the poor and the banks, doorstep “saving and credit” facility for the poor and exploitation of the untapped business potential of the rural areas. Under the SBLP, the following three different models have emerged:

Model I: SHGs promoted, guided and financed by banks.

Model II: SHGs promoted by NGOs/ Government agencies and financed by banks.

Model III: SHGs promoted by NGOs and financed by banks using NGOs/formal agencies as financial intermediaries.

ii. Micro Finance Institution Approach:

While the SBLP model remains the most widely used model of micro finance in India, the MFI model has also gained momentum in the recent past. The MFI model in India is characterized by a diversity of institutional and legal forms. MFIs in India exist in a variety of forms like trusts registered under the Indian Trust Act, 1882/Public Trust Act, 1920; societies registered under the Societies Registration Act, 1860; Co-operatives registered under the Mutually Aided Cooperative Societies Acts of the States; and non-banking financial companies (NBFC)-MFIs, which are registered under Section 25 of the Companies Act, 1956 or NBFCs registered with the Reserve Bank. These MFIs are scattered across the country and due to the multiplicity of registering authorities, there is no reliable estimate of the number of MFIs. The most frequently used estimate is that their number is likely to be around 800. Attempts have been made by some of the associations of MFIs like Sa-Dhan to capture the business volume of the MFI sector.

iii. Banking Correspondents (BC):

In January 2006, the Reserve Bank permitted banks to utilize the services of NGOs, MFIs (other than NBFCs) and other civil society organizations as intermediaries in providing financial and banking services through the use of business facilitator and business correspondent (BC) models. The BC model allows banks to do ‘cash in – cash out’ transactions at a location much closer to the rural population, thus addressing the last mile problem. The BC model uses the MFI’s ability to get close to poor clients – a necessity for savings mobilization from the poor – while relying on the financial strength of the bank to safeguard the deposits. Pursuant to the announcement made by the Union Finance Minister in the Union Budget 2008-09, banks were permitted to engage retired bank employees, ex-servicemen and retired government employees as business correspondents (BCs) with effect from April 24, 2008, in addition to entities already permitted earlier, subject to appropriate due diligence.

iv. Joint Liability Groups (JLGs):

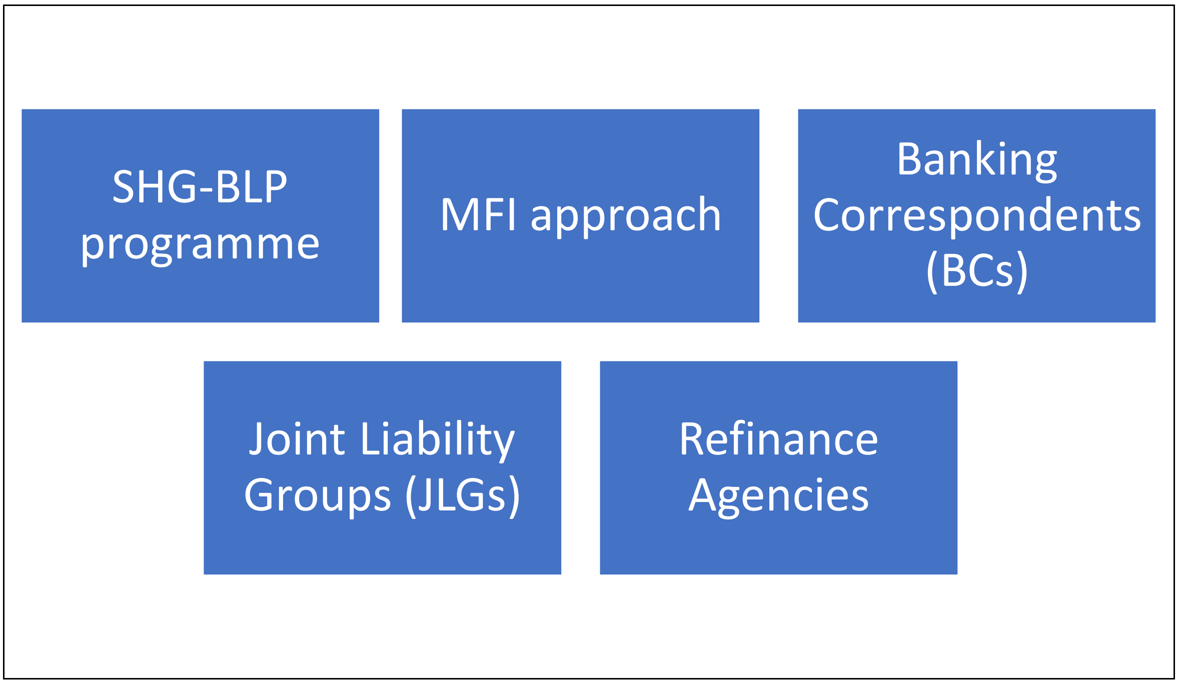
NABARD developed the idea of Joint Liability Groups (JLGs) as an effective credit product for difficult-to-bank to clients like landless labourers, share-croppers, tenant farmers & oral lessees which aims at facilitating hassle-free, long-term credit; fulfilling seasonal needs of credit larger in quantum. The product however, relies on mutual guarantee of clients like small /marginal/tenant farmers, oral lessees and sharecroppers, micro-entrepreneurs, who have no conventional collateral to offer, and thus leverages on social collateral offered by the members.

v. Role of Refinance Agencies:

Refinance agencies play a very crucial role of financers for MFIs, who in turn lend to clients. This includes the MUDRA Bank and the NBCFDC. The Micro Units Development and Refinance Agency (MUDRA) Bank was registered in and commenced operations in 2015, after announcements announcing this in the Union Budget for FY 2015-16, announced the formation of MUDRA Bank. It envisages acting as a refinancing agency to all last-mile financers like NBFCs, MFIs and Societies and Trusts, with the primary motive of financing the credit requirements of the severely underfinanced Non-Corporate Small Business Sector (NCSBS) and promoting entrepreneurship and gainful employment in the sector.

The Microfinance Scheme of the National Backward Classes Finance and Development Corporation (NBCFDC), under the Ministry of Social Justice and Empowerment, Government of India, aims at providing microfinance to target groups, who happen to be low-income groups from backward classes, through nominated channel partners, typically banks, and encouraging inclusive entrepreneurship opportunities.

Figure 1-3: Approaches to Microfinance in India



DEFICIENCIES AND DRAWBACKS

As exposed by the 2010 Andhra Pradesh crisis, the microfinance sector suffers from certain deficiencies and drawbacks, which include:

1. **Over-indebtedness and Multiple Lending**:

The comprehensive regulatory framework envisaged by the Malegam Committee (2011) are applicable only to NBFC-MFIs, while other lenders which comprise ≈70% of the total market portfolio aren't subjected to these regulations. This not only means that small borrowers can borrow simultaneously from several lenders in multiple amounts which only exposes them and the MFIs to greater risk of default, but was also observed to have resulted into coercive debt recovery actions on part of the MFIs. Also, the declining share of NBFC-MFIs in overall microlending activities means that the ceilings imposed on the amounts lent are often unheeded, resulting in worsening off the borrowers, who often tend to be illiterate and thus, more prone to being victimized by fraudulent practices.

2. **Pricing of Microfinance Loans**:

A wide range of regulatory instructions and clarifications over the years have resulted into a labyrinth of complex set of rules governing the sector, adding to ambiguity pertaining to the cost of funds. While the regulatory ceiling on interest rate is applicable only to NBFC-MFIs under the Malegam Committee recommendations, this results into the unintended consequence of not letting competition play out amongst these lenders , reducing their overall market share , and also nudging other players to use these rates as benchmarks , despite the latter having comparatively lower cost of funds (how much banks and financial institutions spend in order to acquire money to lend to their customers i.e. the interest rate banks must pay when they borrow from the central monetary authority) . Even among NBFC-MFIs, increasing size of the operations ideally leading to greater economies of scale hasn't resulted in any perceptible decline in their lending rates. As a result, it is the borrowers who are getting deprived of the benefits from enhanced competition as well as economies of scale, culminating in a non-level playing field which results in customer protection getting compromised.

3. **High Interest Rates and Alleged Use of Coercion:**

A criticism often levied on MFIs has been the higher interest rates levied by them as compared to those levied by commercial banks, with the average interest rates hovering around 23%. While this is believed to be in compensation of the high transaction costs involved in servicing of these loans, risk of default and earning a margin to ensure sustainable continuation of operations, it needs to be noted that both the amount and the duration of these microloans is shorter compared to those taken from commercial banks, and are still lower than those levied by the traditional moneylenders which were also beyond the ambit of the formal banking system.

Also, the high costs incurred on operations, right from accessing clients in inaccessible locations to organizing weekly collection meetings and also providing them supplementary social facilities like insurance are cited by MFIs as being responsible for the high interest rates charged, as also the fact that most funds lent by the MFIs are in fact borrowed from commercial banks or private equity (PE) and venture capital (VC) funds.

However, with the Andhra Pradesh Microfinance Crisis of 2010, amid reports of suicides by debtors and the alleged use of coercion by the MFIs and other intermediaries to ensure debt repayment, there has been subsequent government intervention to regulate the sector in the larger view of public interest, first in the form of the Andhra Pradesh Micro Finance Institutions Ordinance, 2010 and the YH Malegam Committee recommendations of 2011.

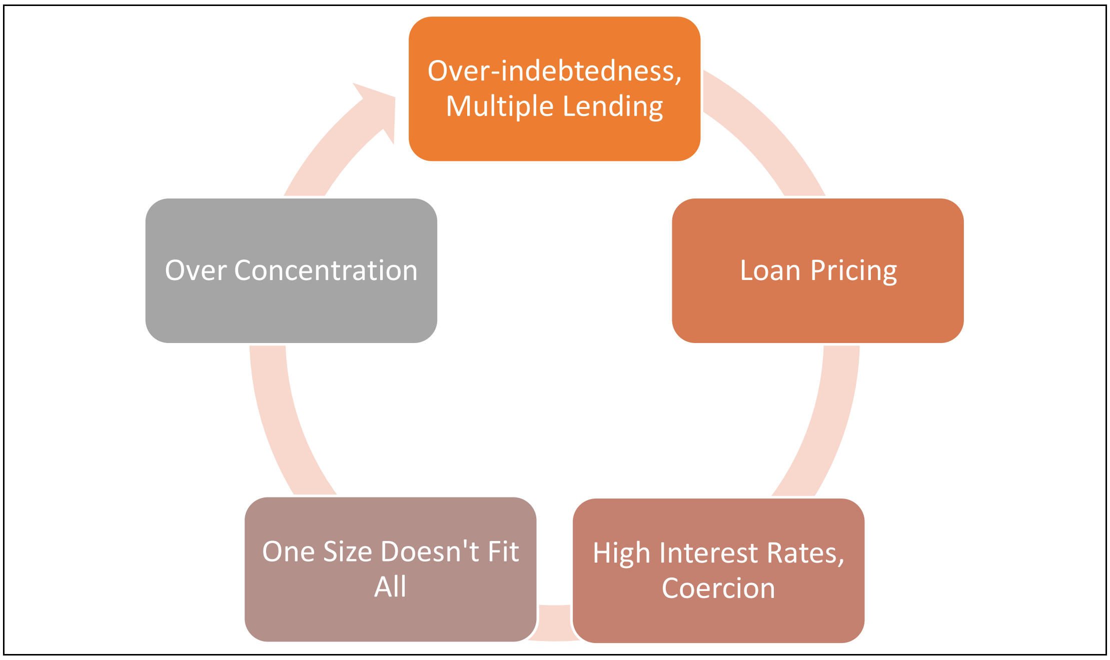
4. One Size *Doesn't* Fit All:

The uniform approach of microcredit widely advocated with rising popularity of the Grameen model of microfinance which makes small loans, usually to women, requiring collateral ostensibly showed high repayment and low default. But, with seven randomized evaluations conducted by the economists Abhijit Banerjee, Dean Karlan and Jonathan Zinman (2016) show that this type of" one size fits all" microcredit product did not increase the average incomes or consumption of households. Expanded access to microloans did lead some entrepreneurs to increase business investments, but rarely to increased profits; only one study found that microloans increased women's decision-making power. This brings us to one of the remedies which can enhance the sector's effectiveness, discussed later in this paper.

5. Increasing Risk of Over-Concentration:

As the given data from the RBI and maps visualized by the SIDBI show, there is an increasing concentration of microcredit disbursement in certain states, namely Tamil Nadu, Bihar, West Bengal, Karnataka, Uttar Pradesh and Maharashtra, over the last few years. This exposes the sector to greater concentration of MFIs activities pertaining to credit disbursement on one hand, but also increases the risks of systemic failures due to defaults on the debtors' end. Similarly, as Sriram (2012) points out, this excessive concentration was resulting not from increasing coverage as it might appear, but rather due a mixture of debtors re-availing loans on one hand and government policies nudging an expanded role of SHG-MFIs on the other, as seen in the Indira Kranthi Patham (IKP) programme under the Society for the Elimination of Rural Poverty (SERP) of the Government of Andhra Pradesh, and schemes like the Kudumbashree programme in Kerala.

Figure 1-3: Issues concerning the microfinance sector in India



THE NEED FOR AN OVERHAUL:

The current regulatory framework for NBFC-MFIs has been put in place with the objective of making credit available to low-income households in a transparent manner while ensuring borrowers' protection from any sharp practices adopted by the lenders. However, this framework again is applicable only to 30 per cent of the microfinance loan portfolio. The emerging dynamics in the microfinance sector as well as the concerns of customer protection call for a review of the regulations so that all the regulated entities (REs) engaged in microfinance pursue the goal of customer protection within a well-calibrated and harmonized set-up.

It was this motive that the Reserve Bank of India (RBI) constituted the Y.H Malegam Committee in 2011 and formulated the Consultative Document on Regulation of Microfinance in 2021, in view of the changing dynamics of the microfinance sector.

Table 1.3: Some key recommendations of the Malegam Committee (2011) include:

- Creation of a separate category of NBFC operating in the microfinance sector to be designated as NBFC-MFI.

- Criteria for defining 'microfinance loans' classified as 'qualifying assets.
- Prudential norms on capital adequacy and provisioning requirements.
- Prescriptions related to pricing of credit in terms of a margin cap and interest rate ceiling on individual loans.
- Transparency in interest charges as well as other terms and conditions of the loan.
- Measures to address multiple lending, over-borrowing and coercive methods of recovery.
- Establishment of a proper system of grievance redressal.

(*Source: Consultative Document on Regulation of Microfinance (2021), Reserve Bank of India*)

THE WAY AHEAD...

Having looked into the problems adversely affecting the microfinance sector in India, it becomes necessary to formulate solutions to untap the unlocked potential of the microfinance sector and make it more client-responsive and operationally sustainable. Often these aren't necessarily complex changes in the regulatory mechanism but simple tweaks to the existing mechanisms. These include:

1) **Savings Accounts...with a '*behavioural*' twist:**

Savings accounts can act as safety nets, which if apply insights from the behavioural sciences, can prove as a deterrent for many borrowers, including those from the lowest income groups, from habitually resorting to borrowing and thereby, exposing themselves to over-indebtedness and also endowing them with a sense of self-reliance and financial independence.

This idea emanates from the simple observation that people don't need to borrow money during a personal crisis if they have their own savings. One study showed that just eliminating the costs associated with opening a savings account in Kenya significantly increased uptake, overall savings, and investment levels among market vendors. However, while replication studies in Uganda, Malawi, and Chile also found that removing account opening costs increased savings, this was partially offset by a reduction in informal savings and there were no observed impacts on business investment or income. In Nepal, offering female-headed households a no-fee basic account with deposit collection service (i.e., tellers came to their home) led to high uptake and usage and real improvements in welfare. Households responded better to health shocks and spent 20 percent more on education and 15 percent more on meat and fish.

Often, the beneficial impacts of savings accounts can be enhanced by features that help people overcome behavioral biases by, for instance, fortifying willpower. So-called “commitment savings” products have lock-up periods, fees, or other penalties for early withdrawal that “commit” the client to a savings goal. Likewise, while behavioural biases like “mental accounting” restrain people’s spending by compartmentalizing expenses and incomes and can thereby “mentally lock” some fixed amounts in savings accounts while the “status quo bias” can ensure that people are nudged to respond to certain choices the monetary authorities want them to , the ‘Default’ option for instance; in Kenya, a simple “Safe Box” that allowed users to save for preventive or emergency health in a metal box to which they had a key increased achievement of health savings goals by 14 percentage points.

2) **Multiple Product Offerings:**

Microlendees can be further encouraged to explore and invest their earnings into other financial products like micro-insurance, which can result in both financial deepening and broadening, thereby resulting in greater, all-inclusive and sustainable financial inclusion and subsequent value addition.

An instance where such micro financial products can prove complementary to the needs of the MFIs client base is micro-insurance against crop. For example, in Ghana, farmers who received rainfall index insurance cultivated more land and spent 13 percent more on fertilizer and labor than those who received just cash, implying that uninsured risk — not lack of access to capital — is a primary constraint on investment by farmers. However, despite the potential of insurance products to provide a “risk floor” for farmers and encourage higher-productivity investments and behavior, uptake at market prices is extremely low and commercial offerings have not found a profitable delivery model. Micro-insurance is not at scale anywhere except when heavily subsidized by government, which presents an untapped opportunity for the MF sector to expand into.

3) **Leveraging Technology…**

Digital platforms have the potential to change financial services in three ways. First, they may reduce financial institutions’ costs. Second, they can increase the reach of financial products, as traditional brick and mortar channels make it difficult to deliver financial products to people in remote areas. And third, digital platforms can facilitate innovation in product and service design. For example, digital platforms can be configured to improve the customer experience by offering sub-accounts or labeling accounts, and they can provide bank managers with real-time information and other decision aids that can help banks provide better service to clients. Yet there are potential downsides for the bank and the client, since digital products are accessed and disbursed digitally without any face-to-face interaction. Financial institutions must adjust how they analyze client risk, collect payments, optimally cross-sell products without getting to know customers in person. Lack of customer contact could drive up default rates, if not dealt with properly. Ultimately, digital finance may alter client behavior dramatically—for better or worse—with instant access to financial products and information, new user interfaces, and other accompanying changes.

4) Transparency of Interest Rates:

As highlighted by the 2010 Andhra Pradesh crisis, a key factor resulting into loss of confidence in MFIs was an apparent lack of transparency of interest rates, which often misguided debtors, aggravated debtors' distress and made them feel a loss of bargaining power vis-`a-vis the MFIs; indeed, one of the key provisions of the 2010 Ordinance was that MFIs prominently display interest rates in their branches and also inform debtors about the same. This will not only reinforce consumer confidence and encourage further transactions, but also result in lower transaction costs for the MFIs themselves , and greater information symmetry can significantly nudge potential clients to avail MFI services and their greater profitability and transparent operation models can attract equity funding , which ensures positive returns for investors on one hand and diversified portfolios and income sources for the MFIs on the other , which in turn can reduce insolvency risks .

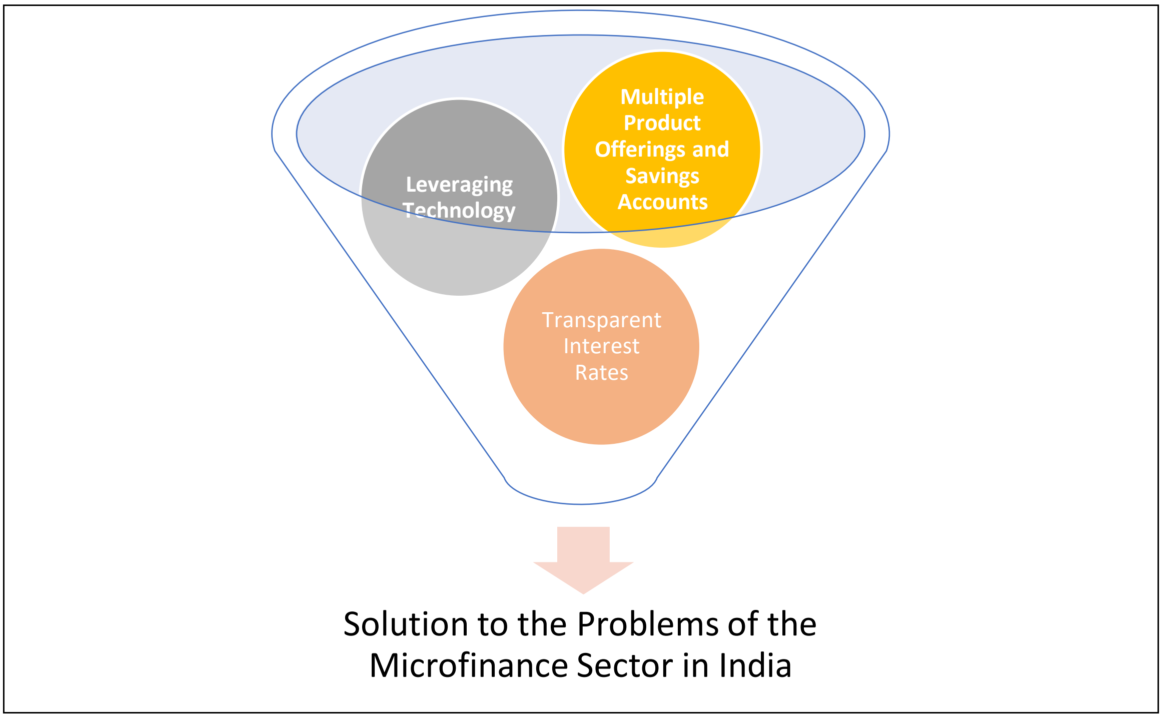


Figure 1-4: Solutions to the Problems of the Microfinance Sector in India

CONCLUSION

The microfinance sector in India has trod a long path, from the Sewa Bank in 1974, to recognition of the sector in the 1990s by the RBI and the NABARD, and to the MUDRA Bank in 2015. The sector, while unleashing immense opportunities for the most marginalized and socio-economically deprived to improve their loves through the power of social cohesion and a slight policy nudge, has also been occasionally at loggerheads with the political establishment and faced the ire of the general public, stakeholders and lawmakers at times. However, it also offers an opportunity for achieving greater equity and inclusive and sustainable growth with the leveraging of technology.

APPENDIX

LIST OF ABBREVIATIONS USED

RBI	Reserve Bank of India
ADB	Asian Development Bank
NABARD	National Bank for Agriculture and Rural Development
SIDBI	Small Industries" Development Bank of India

MFI Microfinance Institution

SHG Self- Help Group

NBFC Non- Banking Financial Company

BLP Bank Linking Programme

AP Andhra Pradesh

ILO International Labour Organization

SERP Society for the Elimination of Rural Poverty

DFI Development Financial Institutions

OJK Otoritas Jasa Keuangan

MUDRA Micro Units Development and Refinance Agency

NBCDFC National Backward Classes Development and Finance Corporation

REFERENCES

- https://www.imf.org/external/np/pp/eng/2005/012505.pdf
- https://www.adb.org/news/features/how-microfinance-helping-poor-households-and-businesses-survive-and-thrive-6-things
- https://www.ojk.go.id/en/kanal/iknb/Pages/Microfinance-Institutions.aspx
- https://www.investopedia.com/terms/m/microfinance.asp#toc-what-is-microfinance
- https://www.nabard.org/auth/writereaddata/tender/SoMFI-2020-21.pdf
- https://www.worldbank.org/en/publication/globalfindex/Data
- https://www.rbi.org.in/Scripts/PublicationsView.aspx?id=20377#11
- https://www.nabard.org/auth/writereaddata/tender/NABARD%20SMFI%202019-20_compressed.pdf
- https://www.iadb.org/en/news/webstories/2004-10-19/better-microfinance-through-remittances-and-technology%2C2151.html
- https://hummedia.manchester.ac.uk/institutes/gdi/publications/workingpapers/bwpi/bwpi-wp-15711.pdf
- https://assets.kpmg/content/dam/kpmg/in/pdf/2019/12/MFI-Microfinance-contributions-to-financial-inclusion.pdf
- https://www.sidbi.in/files/article/articlefiles/MFI-Pulse-12th-Edition---Final-Draft.pdf
- http://www.sa-dhan.net/bharat-microfinance-report/
- https://www.bis.org/publ/bcbs175.pdf

- https://www.ilo.org/wcmsp5/groups/public/---dgreports/---gender/documents/meetingdocument/wcms_091581.pdf
- https://www.forbesindia.com/article/thunderbird/the-interest-rate-myth-in-indian-microfinance/22212/1
- https://blogs.worldbank.org/psd/are-microfinance-interest-rates-too-high
- https://www.ojk.go.id/iru/BE/uploads/policy/files/file_87bf243c-3c2b-4230-9ba2-cad0a6685c9d-19052022144124.pdf
- https://economictimes.indiatimes.com/news/economy/finance/rbi-removes-26-interest-rate-cap-on-mfi-loans/articleshow/30004542.cms
- https://www.indiacode.nic.in/bitstream/123456789/15655/1/ap_micro_finance_institutions_%28regulation_of_money_lending%29_act%2C_2011.pdf
- https://www.business-standard.com/article/opinion/vijay-mahajan-micro-loans-macro-returns-110101600064_1.html
- https://hbr.org/2016/10/making-microfinance-more-effective
- http://economics.mit.edu/files/10475
- https://www.srcc.edu/system/files/Pg%20169184%20Vandna%20Sethi%20%3B%20Evolution%20of%20Microfinance%20in%20India.pdf
- https://www.mudra.org.in/FAQ
- https://nbcfdc.gov.in/loan-scheme-description/6/en
- https://core.ac.uk/download/pdf/234646976.pdf